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RECENT EFFORTS TO ADVANCE FREIGHT RATES¹

For more than a decade the trunk lines operating in Official Classification territory (north of the Ohio and Potomac and east of the Mississippi rivers) have been spasmodically advancing their rates on certain important commodities, such as glass, iron and steel, brick, cement, grain, coal and coke. Most of these advances took place in the years 1903 and 1907. They were considerable in amount and affected a large proportion of the tonnage of the carriers.²

Class rates on the eastern lines have remained nominally the same ever since 1887 when the official classification was adopted. There have been, however, several important changes in the classification itself. Many articles have been changed from one class to another or have been taken entirely out of the classified list and given commodity ratings. There is no general agreement as to the net effect of these changes in classification on rates. In the recent investigation made by the Interstate Commerce Commission, the attorney for the New York Central lines claimed that "the general tendency of the changes . . . in classification has been downward."³ A witness for the shippers, however, presented an exhaustive statement which (after being corrected) indicated that in 592 instances the existing rates on classified articles were higher than in 1900 and in 261 instances they were lower.⁴ The commission itself in its *Annual Report* for 1910 concluded that since "the railway witnesses all agreed in this that the moving and only purpose in the greater part of these changes was to obtain more revenue by advancing rates," it might fairly be assumed that the net effect of the changes in classification was to increase the rates to the shipper.⁵

¹ *Evidence taken by the Interstate Commerce Commission in the Matter of Proposed Advances in Freight Rates by Carriers*: Docket No. 3400, (Eastern Case); Docket No. 3500, (Western Case); 61 Cong., 3 Sess. Sen. Doc., No. 725. Ten volumes, paged consecutively. (Washington: Government Printing Office. 1911. Pp. 6309. \$4.60.) These volumes contain the hearings before the Commission, the briefs and arguments of counsel, the statistical exhibits and the decisions of the Commission besides an index. Unless otherwise stated, all references are to this report.

² P. 4543.

³ P. 5349.

⁴ Pp. 3159-3177; 4546.

⁵ *Annual Report*, p. 14.

As a partial excuse, at least, for these increases in rates on both the classified and the unclassified commodities, it may be said that during the last decade of the nineteenth century, rates on the eastern roads had been unusually, perhaps abnormally, low. Competition between the roads in this territory was unusually severe during these years and all efforts to regulate and restrict it had proved futile until the close of the century. President Cassatt of the Pennsylvania Railroad, in his annual report for 1899, stated that there had been an almost steady fall in the average ton-mile rate on that road from 0.686 cents in 1889 to 0.473 cents, "the lowest point ever reached," in 1899, and that "railroad managers have not seen this constant reduction without serious concern, or without making strenuous efforts to check the downward movement."⁶

The effective way in which this downward tendency of rates was checked was by the adoption of what is generally known as the "community of interests plan." An "understanding" was reached between the officers of the two principal trunk lines in official classification territory, the New York Central and the Pennsylvania roads, by which these two strong lines undertook to secure a controlling interest in the lines of their weaker and most troublesome competitors. This control was secured and the reduction of rates which, as President McCrea of the Pennsylvania said, had threatened the railroads with insolvency⁷ was checked; checked to such an extent that the average ton-mile rate which in 1899 was at the lowest point went in 1904 to the highest point, since when, as Mr. McCrea stated, "it has been keeping along a level or perhaps a practical level."⁸ That the community of interests plan made possible, if it did not actually cause the increase of rates during the years following 1899 seems to be admitted by railway officials as well as by others.⁹

Aside from the changes in commodity rates to which reference has already been made and the changes in class rates due to changes in classification, no effort seems to have been made by carriers in official classification territory to advance rates openly until 1908. In the early part of that year the eastern carriers let it be known that, owing to recent advances in wages which they

⁶ Quoted on p. 4969.

⁷ P. 2301.

⁸ *Ibid.*

⁹ "It accomplished its result."—McCrea, p. 2301.

had granted to their employes and to the general rise of prices, they contemplated making a general increase in their freight rates. It was commonly reported that this advance was to take the form of a 10 per cent horizontal increase of all rates. In response to this announcement, the Illinois Manufacturers' Association called a conference of shippers and commercial organizations to meet in Chicago May 15, 1908, to take action against the proposed advance in freight rates. The conference was attended by representatives of many commercial organizations and it adopted strong resolutions which (1) protested against any increase in the freight rates; (2) proposed to the carriers that no increase be made until the question as to its reasonableness be submitted to the Interstate Commerce Commission; and (3) notified the carriers that unless they consented to the above proposal, the shippers, acting through a regularly constituted committee, would take steps to secure a judicial injunction against the advance in rates.¹⁰ Owing to this strong protest on the part of the shippers, the carriers announced that no immediate steps would be taken to bring about a general increase of rates. The matter was not allowed to drop, however, for Mr. C. S. White, general traffic manager of the Baltimore & Ohio Railroad, testified before the commission that for two years prior to the announced advance of 1910, not only his own road but other roads had been working out the details of an increase in both the commodity and class rates.¹¹

During the early part of the year 1910, the employes on many railroads both east and west of the Mississippi River, acting through their labor organizations, made demands upon the railway managers for an increase of their wages. A few roads (especially the Canadian ones) resisted these demands for a time until forced to accede by strikes; other roads consented to an increase or secured the arbitration of the question under the Erdman Act or through other arbitrators. In all cases the result was that considerable increases in wages were allowed.

Although public opinion was doubtless favorable to an increase of wages and the roads would doubtless, ultimately, have been

¹⁰ *Proceedings of Conference of Shippers and Commercial Organizations held under the Auspices of the Illinois Manufacturers' Association to Oppose the Proposed Increase in Freight Rates in Official Classification Territory*, pp. 66-68 (Chicago, 1908).

¹¹ Pp. 2189-2192.

obliged to consent to an increase, it must be said that in view of the unfavorable financial conditions with which the railroads later claimed they were confronted at this time, most of the roads offered surprisingly little resistance to these demands upon the part of their employes. There are many things, indeed, which point to the conclusion that the roads had already planned an increase of rates (as indicated by the testimony of Mr. White, already referred to) and that they had perhaps a tacit understanding with their employes that wages were to be raised and that the roads would then have the support of their employes in seeking to recover this advance through an increase of freight rates.¹²

Following the demands for increased wages on the part of their employes, the carriers in official classification territory filed with the Interstate Commerce Commission in the early part of the summer of 1910 tariffs naming an increase in all class rates and in about one half of the commodity rates. The increase in the class rates varied from 8 per cent in the sixth class to 20 per cent in the first, second and third classes. By the Pennsylvania and the Baltimore & Ohio railroads an exception to this advance in class rates was made for a strip of territory extending for 200 or 300 miles southwest of New York City. The railway traffic managers said that rates within this territory were already too high in comparison to the long distance rates.¹³ The more probable reason for the exception, however, seems to be that President Baer of the Reading Railroad refused to advance his local rates and consequently his competitors could not do so.¹⁴

The advance in the commodity rates was much less than for the class rates and did not apply to such commodities as coal, coke, pig iron, ore, brick, grain and grain products, which move in large volume and constitute the bulk of the tonnage of the trunk lines. The rates on these commodities had already been raised in 1903 and 1907, and it seems to have been thought that they were already sufficiently high.

¹² See address of Pres. Brown of the N. Y. Central to the Brotherhood of Locomotive Engineers, Oct. 11, 1908, pp. 2530-31. See also testimony of Mr. P. H. Morrissey, former president of the Order of Railway Trainmen, urging an advance in rates, p. 4365. See also confidential letter from the roads to their employers asking their support for the advance in rates, pp. 4235-4236.

¹³ Pp. 1909, 2187.

¹⁴ P. 3146.

At the time that the advance in rates on the eastern roads was announced the railroads west of the Mississippi River, operating in what is known as Western Trunk Line, Trans-Missouri and Illinois Freight Committee territories, and which correspond, roughly speaking, to the territory traversed by the Burlington lines, announced an increase in about 200 commodity rates.¹⁵ Taking the Chicago-Omaha rate as typical of rates in this territory, the increase varied from 1½ cents to 35 cents per 100 pounds and was supposed to represent an average increase of about 10 per cent.

At the time these tariffs were filed, the Mann-Elkins amendment to the Interstate Commerce Act, which, among other powers conferred upon the commission gives it the right to suspend an advance in rates until a hearing can be had on their reasonableness, had not yet passed both houses of Congress, and the commission was therefore unable to take any action in the matter until the rates should go into effect. There was much opposition on the part of shippers to the advance in rates and the United States government was asked to intervene by securing an injunction against the advance on the grounds that it was made by agreement between the roads and was, therefore, in violation of the Sherman Anti-trust Act.

In pursuance of this suggestion from the shippers, the Attorney General brought suit against certain western roads in the circuit court for the seventh circuit and secured a temporary injunction against the increase of rates, pending the hearing of the case. Previous suits in the Federal courts had shown that the Anti-trust Act was applicable to railroads and these suits had led to the dissolution of certain railway combinations and certain traffic associations formed by the roads. The carriers feared that the suit which had been begun and other suits which would follow might lead to the dissolution of existing railway alliances, and thus cause a return to the old conditions of intense competition. They accordingly appealed to President Taft, asking that the suit be withdrawn and promising him that if this were done they would suspend the increases in rates until Congress had completed its deliberations and a hearing could be had before the Interstate Commerce Commission. The suit was accordingly withdrawn and the railroads postponed the effective date of the tariffs from August 1 to November 1, 1910. After the amendment to

¹⁵ P. 3631.

the Interstate Commerce Act had passed, the commission began the hearing of the cases in Chicago and New York in the latter part of August. The taking of testimony proceeded until December 3, briefs were filed by January 1, 1911, and the oral arguments of counsel were heard before the entire commission on January 9 to 19. The commission gave its decision in both cases on February 22. In the meantime, acting upon the suggestion of the commission, the railroads had again postponed the effective date of their tariffs until February 1 and still later until March 15, 1911.

Some of the testimony was heard by examiners for the commission but, as the examination proceeded and the importance of the investigating began to be realized, shippers demanded that the members of the commission themselves conduct the hearings. Accordingly at most of the hearings in both the Eastern and the Western cases, one or more of the commissioners was present to conduct the hearings. The railroads called their most important officials as witnesses, including the presidents of the Pennsylvania, the New York Central, the Baltimore & Ohio, and the Santa Fe roads. Experts in traffic matters and in business management appeared for the shippers. Both sides and the commission itself were ably represented by counsel, and the attorney for each road called his own witnesses and presented the evidence for his road.

The importance of the case is to be judged, however, not by the standing of the witnesses and the counsel present, but by the fact that the case was clearly intended to test the attitude of the commission towards the policy of the railroads in the future.¹⁶ Many railway officials frankly admitted that if these advances were approved by the commission, they contemplated making further ones.

The entire record of the two cases covers more than six thousand closely printed pages, and in spite of many repetitions and much irrelevant material which it contains, this report must be regarded as the most important source of information concerning the present condition of the railroads north of the Ohio and east of the Missouri river which is now open to the public.

That provision of the Mann-Elkins Act, which confers upon the Interstate Commerce Commission the power to suspend rates until a hearing has been had on their reasonableness, contains also the

¹⁶ Statement of Commissioner Lane, p. 5365.

following statement: "At any hearing involving a rate increase . . . the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the common carrier," etc.

The meaning of this sentence and the obligation which it imposes upon the carrier would appear to be clear to any layman, but a prolonged dispute as to its significance took place between the attorneys for the carriers and those for the shippers. Counsel for the defense claimed that they had sustained the burden of proof required by the statute when they had proved *that an increase of rates was warranted* by changed conditions and that they were not under obligations to show that *the increased rate was itself reasonable*. As stated in the carriers' brief in the Eastern rate case, "It seems to be reasonably clear that Congress by the provision in question did not intend to require that carriers, in the event of an advance in their rate being challenged, would have to go farther than to show a good reason for the advance."¹⁷

The argument advanced for this peculiar interpretation was that Congress intended to accomplish the same purpose as that held in mind by the British Parliament when on August 5, 1894, it passed a statute (57-58 Vict., Cap. 54) which enacted that when a railway company had increased a rate and complaint was made in regard thereto, "it shall lie on the company to prove that the increase of the rate or charge is reasonable."¹⁸

In interpreting this phrase Lord Justin Kay said (Mansion House Assn. etc. V. L. & N. R'y Co., 9 R. & C. T. cases, 174, at p. 101):

"Where there has been an increase, if any complaint is made that the rate or charge is unreasonable, it shall lie on the company to prove that the increase—not that the rate or charge, but that the increase of the rate or charge—is reasonable."¹⁹

It was closely brought out, however, by Mr. Glasgow, a Philadelphia attorney, who made a study of the English statutes and decisions for the commission, that the circumstances surrounding the passage of this statute in England, where Parliament has provided a schedule of maximum rates for the railroads and canals, were quite different from those in the United States, and that the

¹⁷ P. 4729.

¹⁸ P. 4593.

¹⁹ P. 4594.

purpose of Congress in enacting the clause in question was merely to shift the burden of proof concerning the reasonableness of rates from the shoulders of the shippers, where it had been placed by the original act of 1887, to those of the carriers.²⁰

The extreme point on the other side of the argument seems to have been reached by Mr. Lyon, the attorney for the commission, who said that "the commission must take up each rate advanced and determine whether it, individually, is reasonable."²¹ The commission itself, when it came to discuss the question, does not seem to have accepted either the argument of the defendants' counsel or the extreme point of view presented by its own attorney.

Both Commissioner Prouty in the Eastern rate case decision and Commissioner Lane in that of the Western case declared that the burden of proof was on the carrier to justify the "increased rate," but they did not argue that this justification must necessarily be separately made for each rate. The commission is not debarred from considering and passing judgment upon the question as to whether or not a general advance in rates is reasonable, but if they do justify such an increase generally, this will presumably not prevent a shipper from attacking the reasonableness of any one of these rates and having his complaint passed upon by the commission. Commissioner Lane said:

"The assumption of the law is that the railroad which increases its rates takes such action knowing that the law casts upon it—if challenge is made either by this commission or otherwise—the burden of justifying its action. . . . The railroad must assume to prove to this commission that the new and increased rates are within the words of description and limitation used in the act; that is, that they are just and reasonable, and to say that they must prove this is to say that they must satisfy our minds of this fact."²²

By the circulars sent out by the railroads and by newspaper statements inspired by them prior to the taking up of the investigation by the commission, the public was led to expect that the carriers intended to defend the proposed advances largely by evidence tending to show that there had been within recent years a great increase in the cost of nearly all materials which the roads found it necessary to purchase. When the time came to present their evidence, however, the railroads laid surprisingly little stress on this point. The reason is not far to seek. Certain statements

²⁰ P. 4594.

²¹ P. 4536.

²² P. 5364.

as to the cost of materials were called for from the New York Central lines and from the Baltimore & Ohio, and some incomplete statements were filed by the Illinois Central and the Santa Fe. A study of these figures as well as those prepared by the Bureau of Labor²³ shows that in most cases the articles which carriers had to purchase were *lower* in price in 1910 than they had been on an average during the 10 year period 1901-1910.²⁴ Vice-president Gardner of the Northwestern frankly admitted that whatever increase had taken place in the cost of certain materials had been offset by decreases in the costs of others.²⁵

The principal exceptions to this rule of almost constant cost were coal and lumber. The price of coal had not materially advanced to the eastern carriers but the cost of fuel had shown a considerable advance to the western roads, especially during the year 1910.²⁶ The cost of lumber and ties showed a considerable advance in both the East and West. As partial offsets to this, however, we have the facts that practically all the carriers are now using the creosoted process for prolonging the life of the ties, and that steel or concrete is being rapidly substituted for wood in the construction of bridges, buildings and even cars. "This change carries with it the substitution of a permanent structure for one of a temporary character, while the material of which the permanent structure is formed is declining in price."²⁷

All of the roads using the official classification introduced elaborate statements setting forth the amount of wage increases resulting from the settlement with their employes. The increase in wages in most cases took effect on April 1, 1910. For all the roads in this territory, the estimated increases in wages in 1910 over the year 1909, on the basis of the same number of employes for both years, was in excess of \$34,000,000.²⁸ The estimated increase in revenues which would be produced by the application of the proposed advanced rates to the freight traffic of 1909 was in excess of \$27,000,000. The ratio of increased revenue to the wage increase varied, of course, a great deal on the different roads. On the Lehigh & Hudson River Railroad the estimated increase

²³ *Bulletin*, No. 87, March 1910.

²⁴ Pp. 4561-4569.

²⁵ P. 673.

²⁶ Pp. 3501-3502.

²⁷ P. 4566.

²⁸ Pp. 4532-4533.

in revenues was only 2.07 per cent of the assumed increase in wages. On the New York, Chicago & St. Louis Railway, on the other hand, the ratio was 242.57. The ratio was 43.45 on the Pennsylvania; 96.48 on the New York Central; 132.01 on the Lake Shore; 114.82 on the Baltimore & Ohio; 39.02 on the New Haven and 121.54 on the Erie. The western roads did not furnish such a complete statement as to the increases of wages or their probable effects on net revenues. Some of the wage disputes with their employes were still pending at the time the investigation was being conducted. Such statistics as were furnished showed about the same differences in the ratios which the estimated increase in revenues bore to estimated wage increases as were shown for the eastern roads.²⁹ It is quite apparent from this showing that some carriers were able to place much greater emphasis upon the increase of wages as a reason for advancing rates than could others. Attorney Hyzer of the Northwestern said that the wage increase was the chief thing which induced his company to raise rates,³⁰ while Attorney Gowen of the Pennsylvania stated that the advance in rates was not primarily necessitated by an advance in wages.³¹

The eastern carriers in their general brief, nevertheless, laid great emphasis on the increase in wages as a reason for requiring additional revenue. The statement was made that: "The whole increase in wages is an actual addition to operating cost, as it was based not on any increase in the efficiency of wage earners, but solely on the increased cost of living."³² It was clear, however, that with the statistical exhibit of the carriers showing that in case of some roads the proposed increase of revenues would be several times as large as the admitted increase of wages, while, in other cases, the increase in revenues would constitute only a slight percentage of the wage increases, it would be necessary to find some broader grounds on which to defend the advance in rates by all roads.

This broader ground was found in the statement that the ratio of operating expenses to operating revenues had greatly increased within recent years. In 1900 it was on all the roads of the United

²⁹ P. 3476.

³⁰ *Ibid.*

³¹ P. 5139.

³² P. 4703.

States 64.64 per cent; by 1908 it had risen to 69.75 per cent.³³ The reason for this advance in the ratio was declared to be the enormous increase in operating expenses, due not only to increased wages and higher costs of fuel and supplies, but also to higher taxes and to expenses which were demanded by the public, such as the elimination of grade crossings, construction of expensive stations and terminal facilities and the adoption of safety devices. These expenses, it was said, brought with them little or no increase in income, and accordingly they could be compensated for only by an increase of rates. In earlier years it was said that the increase of expenses was largely for the reduction of grades, the laying of heavier rails, the strengthening of bridges, etc., all of which made possible an "increased hauling capacity of locomotives, increased capacity of cars, and increased volume of business," and thus increased revenues. It was held that such a condition of affairs was no longer possible.

Speaking not only for his own road but for other lines as well, President McCrea, of the Pennsylvania, said:

"So far as concerns economies which will result from reductions in grades, increased hauling capacity of locomotives and increased capacity of cars, the companies are today already practically deriving the full benefit from those which are possible in this direction due to expenditures heretofore made, for we have practically completed our grade reductions and have probably reached the maximum size of our cars and engines."³⁴

In view of the fact that operating expenses were increasing at a more rapid rate, the carriers claimed that an increase of revenues was imperative. The New York Central brief said:

"A point has been reached in the steady convergence of revenues through increased rates which threatens the overthrow of economic policies which have been an essential part of the upbuilding of modern transportation and the development of the nation's commerce. The companies generally, have shown that the rising tide of expense is impairing the surplus earnings of the stronger lines as it is impairing both dividends and surplus earnings of the weaker lines."

President Ripley of the Santa Fe put the matter more bluntly when he said that "perhaps the most potent reason" for raising rates "was that we needed the money."³⁵ While the officials of other roads gave their hearty approval to this terse method of stating the problem, it became quite evident, as the examination

³³ P. 5044.

³⁴ P. 2289.

³⁵ P. 20.

proceeded, that no two roads had exactly the same things in mind for which money was needed, or were in agreement as to the amount needed. President McCrea, of the Pennsylvania, thought that his road should have revenue enough to pay operating expenses, interest on indebtedness, accumulate a sinking fund, pay to its stockholders a 7 per cent dividend, and to accumulate a surplus out of income sufficient to put back into the property one dollar for every dollar paid out in dividends.³⁶

President Willard, of the Baltimore & Ohio, thought that "the very minimum" his road could do would be to pay 6 per cent dividends and put "50 cents in surplus for each dollar paid in dividends on the common stock."³⁷

President Brown, of the New York Central, thought that "a fair return for money invested in railroads should be in some way commensurate with the average returns of money invested in other lines of business," which in farming he thought was in the neighborhood of 10 per cent, in manufacturing and merchandising about 14 per cent.³⁸

President Ripley said:

"So far as the Santa Fe is concerned, I think we ought to earn double what we pay in dividends, at least, for instance, if we pay 6 per cent in dividends, I think we ought to earn 12 per cent on our stock if not more; certainly not less than that."³⁹

The weaker roads, like the Erie and the Wabash in the East, and the Iowa Central and the Minneapolis & St. Louis in the West, could not claim that they had any expectations of securing in the near future such an increase of revenues as would permit such handsome returns to their owners. They were inclined to believe, however, that they were entitled "to earn a fair return for the service they rendered,"⁴⁰ even if this did mean that the stronger lines got high returns. President Ramsey, of the Ann Arbor road which has never paid any dividends on its stock, thought that a railroad should be allowed to earn 6 per cent on its stock and have left a surplus to expend for those improvements which were necessary but did not bring in revenue.⁴¹

³⁶ Pp. 2328-2329. It should be said, in fairness, that Mr. McCrea did not put it in this way, but he defended each of these statements.

³⁷ Pp. 2358-2359.

³⁸ P. 2462.

³⁹ Pp. 29-30.

⁴⁰ Argument of Judge Seevers, counsel for the Iowa Central, p. 4344.

⁴¹ P. 2635.

Nearly all railway witnesses placed great stress on the importance of having an increase of rates in order to improve their credit so that they could borrow capital to make the necessary additions and improvements to their lines. President Brown of the New York Central, expressed the general sentiment of all these witnesses when he said:

"With respect to the capital remaining to be secured for these improvements, I can confidently say that the ability of the railroads to obtain it depends upon the ability of the companies to secure increases in revenue through increased freight rates commensurate with the recent increases in expenses."⁴³

Among the minor reasons advanced for raising rates was cited the increase in speed and the providing a more expensive service, which, it was said, were demanded by the public but added to the expense of the carriers.⁴³ The greater increase in the first three classes of the official classification than in the others, was explained on the ground that these classes contained the greater part of the less-than-car-load ratings, and this traffic was, therefore, the more expensive to move.⁴⁴ The increase in the class rates as compared to the lower increase in commodity rates in the East was explained on the ground that commodity rates had already been raised in recent years, while the carriers, it will be remembered, claimed that changes in classification had brought with them no increase, but rather a reduction in class rates.⁴⁵

In the West, on the other hand, the class rates were not changed and the only increase took place on commodity rates. The principal reason given for selecting commodity rates for an advance was that the commodities whose rates were advanced had originally been in the classes and had been taken out and the rates reduced owing to undue competition.⁴⁶ The attempt to advance rates was due to the desire to restore the rates to something like their former position. Some witnesses, however, claimed that the class rates should also be raised, and that, pending an appeal to the courts, they were not advanced because of the decision of the commission in the Burnham, Hanna, Munger case.⁴⁷

As the burden of the proof is, by the statute, placed upon the

⁴³ P. 2429.

⁴⁴ P. 1952.

⁴⁵ Pp. 4719-4721.

⁴⁶ P. 4717.

⁴⁷ P. 3562.

⁴⁸ P. 2136.

carriers, the counsel for the shippers made little attempt to call witnesses to prove that the proposed advances in rates were unreasonable. Some evidence of this sort was presented by certain witnesses from New England with reference to goods produced in New England and marketed in the Middle West. In the main, however, the counsel for the shippers contented themselves with picking flaws in the testimony and arguments of the railway witnesses, and in endeavoring to show that they had not made out their case for demanding an increase of rates.

The railroads' contention that the \$34,000,000 increase of wages would be only in part compensated for by an increase in rates, amounting to an estimated \$27,000,000, was met by showing that even without the increase in rates, the year ending June 30, 1910, showed an actual increase in net operating revenue of nearly \$55,000,000, so that "the increase in net revenue will more than absorb the increase in wages."⁴⁸

The argument for the shippers which attracted the widest attention and made the greatest impression on the public, if not on the commission itself, was that if the railroads needed additional revenues to pay higher wages, make betterments and additions to property, etc., these could be secured if the railroads would adopt what was called "scientific management."

Mr. Louis D. Brandeis, counsel for the Traffic Committee of Commercial Organizations of the Atlantic Seaboard, introduced a number of business men, engaged for the most part in manufacturing enterprises, who testified that in their businesses they had been confronted with an increase in wages and operating costs similar to those which now confronted the railroads, and that they had been enabled to meet these increased expenses without reducing their profits by the introduction of scientific methods of business management. This scientific management consisted in carefully planning a piece of work before its performance was undertaken. A study was made, partly by means of comparison, partly by analysis, of the simplest and cheapest method of performing a given task. A card of instruction was then issued to the workmen or their foremen, setting forth in minute detail the work to be done and the steps to be followed in doing it. The management saw to it that the workmen were supplied with just the tools and material needed to perform the work. No efforts were made to introduce

⁴⁸ P. 4862.

the ordinary piece-work plan, but the employe was stimulated to follow out the instruction of the manager by the promise of a bonus. It was claimed that in this way the coöperation of the laborer was secured by the knowledge that he was not being over-worked, and that there was no danger in a cut of the piece rates. The employe, under scientific management, was enabled to earn from 25 to 60 per cent and, at times, even 100 per cent more than under the old system, and "without greater strain upon his vitality."⁴⁹

A number of the witnesses testified that they believed that there was no good reason why scientific management could not be applied to most departments of the railroads, and some of them pointed out places where it might be introduced. A few of the experts showed that scientific management had already been introduced, to a limited extent, on several roads and with good results.⁵⁰ One of the witnesses, Mr. Harrington Emerson, claimed that "by the introduction of proper efficiency systems of scientific management, the railroads of the United States could effect an economy of perhaps \$300,000,000 a year or not less than \$1,000,000 a day."⁵¹

The railway attorneys were apparently taken by surprise at the introduction of this line of argument, and made little effort to refute it or to combat it in their arguments. Attorney Ellis, of the Milwaukee road, said that the statement that a million dollars a day could be saved out of the operating expenses of the railroads was a "grotesque vagary of idle dreamers,"⁵² and Attorney Hyzer, of the Northwestern, claimed that the efficiency of American railroads was "the greatest efficiency ever known in human affairs."⁵³ Mr. P. H. Morrissey, for the railway employes, was put on the stand to express the opposition of organized labor to the introduction of the system on the ground that it probably would mean a speeding up of the employes.⁵⁴

The railroads' claim that the ratio of operating expenses to operating revenues was increasing, and that this threatened them with bankruptcy, was met by the statement that this ratio, taken by itself, meant nothing:

⁴⁹ Brandeis' brief, pp. 4756-4788.

⁵⁰ Pp. 4789-4798.

⁵¹ P. 2829.

⁵² P. 3724.

⁵³ P. 3749.

⁵⁴ Pp. 4367-4369.

"The management may, by increasing its standard of maintenance, build up its property through charges to maintenance; and by lowering its standard of maintenance, it may lessen its charges to operating expenses and show a fictitious profit; in other words, there is no rigid connection between actual operation and the charges to the maintenance accounts in operating expenses."⁵⁵

It was shown that the really important thing was whether or not net revenues were decreasing, and there was nothing in the carriers' exhibits to show that this was the case. On the contrary, roads like the New York Central, which were strenuously urging the need of more revenue, had increased their dividends at the very time they were demanding more revenue to make needed improvements.⁵⁶ The carriers contended that an increase of rates was necessary to sustain their credit, and cited their inability to sell their bonds at par or above; but on the other hand it was shown that "there has been no attempt by the carriers to negotiate the sale of bonds bearing a higher rate of interest than 4 per cent." It was agreed that with rising rates of interest 4 per cent was too low a rate.⁵⁷ The price of railway securities was compared with that of good municipal and state bonds to show that the credit of the railway companies was not deteriorating.⁵⁸

Counsel for the shippers further claimed that such loss in credit as the railroads had suffered was due to the pessimistic utterances which the railroads had themselves circulated for several years in their campaign to prepare the public mind to accept an increase in freight rates.⁵⁹ Counsel for the shippers admitted that there was some need for more revenue on the part of some of the weaker roads, but it was claimed that the condition of these roads was due to excessive capitalization, to past or present mismanagement, or to bad location and the fact that the road was not needed. Under these circumstances it was claimed that there was no moral or financial obligation on the part of shippers and consumers to pay increased freight rates in order that these roads might pay dividends to their stockholders.⁶⁰

Much stress was placed by the shippers' counsel and the attorney for the commission, on the fact that an actual increase of

⁵⁵ P. 4582.

⁵⁶ Pp. 4832, 4888.

⁵⁷ Pp. 4548-4552.

⁵⁸ *Ibid.*

⁵⁹ P. 4870.

⁶⁰ Pp. 4885; 4895; 4902.

rates had already taken place in recent years by the abandonment of the practice of giving rebates.

Against the claim of the carriers that in recent years there had been a more expeditious service furnished the shippers, it was said that this part of the service did not constitute a large part of the railway business, and that the trains handling local freight were not specially expedited.⁶¹

Other objections to the increase of rates in official classification territory were that the proposed advances fell upon only 15 per cent of the tonnage, whereas the increase in wages applied to the entire tonnage;⁶² that the distribution of the increase was especially unfair to articles in the first three classes;⁶³ that class rates were unduly advanced as compared to commodity rates;⁶⁴ that the increase in some instances distorted the relation of long distance to short distance rates;⁶⁵ and that shippers were given no opportunity to be heard before the changes in rates were announced.⁶⁶

The campaign of publicity which the railroads had conducted from the platform and through the press had unquestionably produced some effect upon the public mind. Although shippers had not reconciled themselves to the necessity of an advance in rates, perhaps most readers of the newspapers who had not followed closely the testimony and arguments given at New York, Chicago and Washington, had an idea that the railroads had made out their case and believed that the commission would permit some advance in the rates. It was, therefore, to most readers a matter of surprise to learn that in both the Eastern and the Western rate cases the commissioners had unanimously agreed not to permit, for the present, any advance whatever in the rates.

There can be no doubt that the time for attempting to secure the commission's approval for an advance in rates turned out to be very unpropitious from the standpoint of the carriers. As already pointed out the carriers had planned an increase of rates as early as 1908. There had been for the railroads of the United States, taken as a whole, a decline in gross operating revenues, per mile

⁶¹ P. 4547.

⁶² Pp. 4945, 4529.

⁶³ P. 4945.

⁶⁴ *Ibid.*

⁶⁵ P. 4813.

⁶⁶ P. 4809.

of road operated, from \$11,275 in 1907 to \$10,593 in 1908, and the decline continued to \$10,509 in 1909. As operating expenses had shown but little falling off in the meantime, the net operating revenues per mile of road operated had declined from \$3,845 in 1907 to \$3,180 in 1908 and \$3,498 in 1909.⁶⁷ This downward tendency of revenues for the years 1908 and 1909 was more than checked during the year ending June 30, 1910. Both the gross and the net operating revenues of the roads for 1910 were the largest in the railway history of the country, the gross revenues being \$11,822 and the net \$3,913 per mile of road operated.⁶⁸ The amount paid in dividends was also larger and the average rate higher than ever before.⁶⁹ Under these circumstances it is clear that the railroads had undertaken no slight task when they endeavored to sustain the burden of proof that an increase of rates was necessary.

The railway attorneys endeavored to meet this (for them) unfavorable situation by pointing out that the results of the first six or seven months of the calendar year 1910 showed that net revenues were declining, and this decline they attributed to the increase in wages which became operative on April 1, 1910. But the counsel for the commission showed that on the most important eastern roads there had been, for the eight months, April to November, 1910, inclusive, an increase in the operating revenues as compared with the same period for the preceding year, and that the increase in expenses which had caused the net revenues to be less was chiefly due to the fact that the carriers had selected this period for making large expenditures for maintenance.⁷⁰

The same situation was revealed in western territory.⁷¹ Counsel for the shippers even hinted that the carriers might have sought this particular time for making large expenditures for maintenance in order to produce a decline in net earnings, and thus impress the commission with the need for higher rates.⁷² There is no evidence to support the claim that this was the purpose of the carriers. If it were true the move was certainly barren of results. Commissioner Prouty, who wrote the opinion of the commission in

⁶⁷ P. 5367.

⁶⁸ *Ibid.*

⁶⁹ P. 5368.

⁷⁰ Pp. 5133-5138.

⁷¹ P. 3521.

⁷² P. 3231.

the Eastern rate case, not only declared that "there is no evidence before us which establishes the necessity for higher rates" but that "the probability is that increased rates will not be necessary in the future."⁷³

The commissioners took up for discussion each of the reasons advanced by the carriers for asking an advance in rates, and held that in every instance the railroads had failed to prove their case. The claim of the roads that they needed additional revenues in order to pay the increased wage-bill was answered by showing that on the eastern roads "if the entire advance in wages had been in effect during the whole fiscal year of 1910, instead of during a few months in the spring of that year, the net earnings for 1910 would have exceeded the net earnings for 1909 by \$16,000,000."⁷⁴ Commissioner Lane adopted a similar line of argument in the Western decision.⁷⁵

The contention of the roads that they needed enlarged earnings in order to pay the cost of improvements which the law or public sentiment demanded, but which yielded little or no revenue to the carriers, was answered by the statement that there was no real difference between a revenue-producing and a non-revenue-producing improvement. "So long as the improvement is for the future the present must not be entirely taxed to provide it."⁷⁶

The commission was willing to admit that it might be to the interest of the public, as well as to that of the roads, to create a surplus out of earnings to provide for increasing expenses in the future as well as for permanent improvements, but it held that for this purpose the average road required no such surplus as that believed by the presidents of the Pennsylvania and the Baltimore & Ohio to be necessary. It also declared that "to this surplus fund stockholders should be required to contribute by a reasonable reduction in dividends."⁷⁷

The railroads had urged that an increase of rates was necessary in order to sustain their credit and enable them to borrow money on reasonable terms. Neither Commissioner Prouty nor Commissioner Lane would admit that there was any force to this argument. Both of them declared that the inability of the roads to

⁷³ P. 5490.

⁷⁴ P. 5449.

⁷⁵ P. 5418.

⁷⁶ P. 5459.

⁷⁷ P. 5461.

sell 4 per cent bonds at par was in no way due to the impairment of railroad credit, but was to be explained by the fact that interest rates were rising.⁷⁸ Commissioner Prouty said: "There is no reason to suppose that railroad bonds bearing a proper rate of interest might not readily be disposed of today; whether it would be wise for our railroads to sell long-time bonds at the present rate of interest is a question of financing upon which we are not required to express an opinion."⁷⁹ Such unfavorable impression concerning the credit of American roads as had been gained by foreign investors, it was held, was due to the activities of the railroads themselves in permitting pessimistic stories concerning their financial condition to be spread abroad without contradiction on the part of their managers.⁸⁰ The commissioners showed themselves to be somewhat sensitive over the charge that the credit of the railroads had been injured by restrictive regulation on the part of the government.⁸¹ Commissioner Lane said:

"Throughout this record it appears that a literary campaign has been conducted by the use of railroad money with the manifest purpose of establishing both at home and abroad the impression that the effect of railway regulation in the United States is injurious to the American railroad. Widespread circulation has been given to the pessimistic utterances of railroad financiers who sought to fix the idea that injustice was being done our railroads by restrictive and oppressive regulation."⁸²

So far from government regulation being an injury to the roads, Mr. Lyon, the attorney for the commission, forced from President Ripley, of the Santa Fe, the admission that rates in his part of the country had, in the absence of government regulation, not yielded sufficient returns to the carriers, and that now, under regulation, these rates should be put on a paying basis.⁸³ The commissioner commented on this bit of testimony as follows: "Could there be any position less reasonable than to cry out against restrictive legislation and in the same breath ask benefits under this legislation which never were, and admittedly never could have been won in the open field of unlimited competition."⁸⁴

⁷⁸ Pp. 5377, 5446.

⁷⁹ P. 5446.

⁸⁰ Pp. 5366-7; 5446.

⁸¹ Pp. 5366-7; 5446-7.

⁸² P. 5366.

⁸³ P. 81.

⁸⁴ P. 5366.

The claim that the weaker roads were entitled to recognition from the commission, even if it were concluded that the revenues of the strong lines were sufficient, did not receive much consideration from the commission. The officials of these weak roads themselves admitted that they could not raise their rates unless the stronger lines also made an increase, and Commissioner Lane said: "It is almost axiomatic that rates cannot be made so as to give high earnings to a poorly placed, indifferently operated or isolated road without making the rates absolutely extortionate."⁸⁵

Neither the claim that cost of fuel and materials had risen nor that the railroads were offering a more expeditious and expensive service than formerly was acknowledged by the commission to be a sufficient argument for raising rates. On the other hand, considerable emphasis was laid on the withdrawal of rebates since 1906. This, it was held, was practically equivalent to an increase of rates.⁸⁶

The elaborate testimony introduced by Mr. Brandeis to prove that under scientific management the operating costs of the roads could be greatly reduced, did not receive much consideration at the hands of the commission. Commissioner Lane hardly referred to it in the Western rate case.⁸⁷ In the decision in the Eastern rate case, Commissioner Prouty discussed the testimony in these words:

"It is difficult to see exactly what application the Commission can make in this case of this testimony. The witness who apparently had most to do with originating and applying these methods testified that they were in actual operation in not over one-tenth of one per cent of all the manufacturing establishments of this country. The system is everywhere in an experimental stage. To some extent it has been tried and is now being tried by our railways. The representatives of railway labor who appeared before us stated that these methods could not and should not be introduced into railway work. Upon this record we can hardly find that these methods could be introduced into railroad operations to any considerable extent, much less can we determine the definite amount of saving which could be made. We cannot, therefore, find that these defendants could make good any part of these actual advances in wages by the introduction of scientific management."⁸⁸

That the testimony made some impression upon the minds of

⁸⁵ P. 5417.

⁸⁶ Pp. 5395, 5472.

⁸⁷ P. 5418.

⁸⁸ P. 5468.

the commissioners as well as upon the public mind, however, is shown by Mr. Prouty's further statement:

"No general advance in rates should, however, be permitted until carriers have exhausted every reasonable effort toward economy in their business. The inducement to adopt methods of this kind which necessity creates in private occupations does not exist to the same extent in railroad operations. We cannot escape the impression that railroad operators have not given this important subject the attention which it deserves."⁸⁹

Nearly every important witness called upon to testify was asked his opinion as to what constituted a reasonable railway rate. As a consequence, the commission was presented with a bewildering array of theories. Neither counsel for the roads nor those for the shippers were very consistent in their attempt to state and apply fundamental principles. Generally speaking, the railway officials and their attorneys contended that rates should be based on the value of the service to the shipper or what the traffic will bear, but it was plain from their testimony and arguments that they intended these phrases to do little more than to furnish a theoretical defense for whatever rates the roads might seek to collect.⁹⁰

Counsel for the shippers, on the other hand, generally claimed that rates should be based on a fair valuation of the property, excluding therefrom all values due to franchises, to gifts from the public and to the unearned increment.

Mr. Lyon, the counsel for the commission, brought forth the idea that value of service could not, under government regulation, be made the basis of rates "for the primary reason that the value of the service is diametrically opposed to regulation."⁹¹ He held that reasonable rates are "such rates as will, on the whole, make a reasonable return upon the property fairly and honestly dedicated to the public service."⁹²

This is the U. S. Supreme Court's definition of a reasonable rate (*Smyth v. Ames*, 169 U. S. 466), and the commissioners were quite willing to accept it, as indeed they were bound to do.⁹³ Congress has not, however, provided for a valuation of the property or of the roads of the country, and, until this is done, the com-

⁸⁹ P. 5469.

⁹⁰ Pp. 5392-5393.

⁹¹ P. 3478.

⁹² *Ibid.*

⁹³ Pp. 5453-5454.

missioners rightly assert that they are unable to use this as a means of determining the reasonableness of rates. In the Eastern rate case, as heretofore, the commission urges upon Congress the importance of providing for a reproductive valuation of the property.⁹⁴ In the absence of these data as to the value of the railway properties, the commissioners were inclined to place much reliance on such data as were furnished to show the necessary costs of construction and operation. It was on the plea that operating costs had increased that the carriers set forth the claim that rates should be advanced, and the commissioners held that the carriers could not, therefore, object if the commission required them to justify their advance on the basis of higher costs.⁹⁵

Commissioner Lane laid perhaps more emphasis on cost of service as a basis of rate making than did Commissioner Prouty. The former became quite enthusiastic over certain figures furnished by the Burlington as to the costs of moving freight on that road. He said:

"These figures, as a whole, are among the most suggestive to which the consideration of the commission has been directed. They appear to make it possible to overcome the one hitherto insuperable objection which has been raised against the primary basing of rates upon cost. This is the effort in all the great business enterprises of our time—to know what a unit costs the plant. Once we have learned the comparative costs for various services, it is not fanciful to say that a schedule of rates may be made which will approach justice as between services. Supplement cost with scientific classification of freight, giving their due to all the various factors, such as value, bulk and hazard—especially to value—adding return for use of plant, and we have something certainly more nearly akin to reason the hazard of a traffic manager, no matter how benevolently inclined. Such a theory gives force to every factor which the Supreme Court has said should be considered in the fixing of rates for public utilities. The investor would have his return, the value of the property would be cared for as a part of the rate, though this would, of course, vary with the rates as at present, one service making a larger return to capital than another."⁹⁶

While the commission required the carriers to cancel all the advanced rates which had been announced, and to restore their former rates, the way was left open for the carriers later to announce certain advances if conditions seemed to warrant it. The rate increases which in eastern territory were mostly attacked, were the advances in class rates.

⁹⁴ P. 5490.

⁹⁵ Pp. 5399, 5465 ff.

⁹⁶ Pp. 5403-5404.

The advances in commodity rates were objected to in only a few instances. Most of these rates had at one time or another been carried in the class rates and they were at the time of the investigation much lower than they were when they were in the classified list. The commissioners seem to have thought that the carriers might be able to show that these rates had been forced too low by competition and that they might now be better adjusted to the class rates.

It was shown that some rates like those on sugar, coffee and packing-house products were unduly low, that they had remained the same for many years, and were perhaps not bearing their proper share of the costs of transportation.⁹⁷ There is a strong suspicion that the influence of monopoly in these fields of production and trade has made itself felt to keep rates on these commodities lower than would otherwise be the case.

In issuing its order in the Eastern case, the commission said that "we dislike to tie up, by hard and fast order, these commodity rates,"⁹⁸ and while the carriers were required to cancel the announced advances on commodity rates as well as on class rates, it is likely that if, in the future, the carriers find their net revenues decreasing, and if they come before the commission with an application to be allowed to increase certain specified rates on commodities or to change the classification of other articles in such a way as to bring an increase of revenues, and if at the same time they are able to show that these particular commodities or articles of commerce are not bearing their fair share of the costs of transportation, they will find the Interstate Commerce Commission willing to lend an attentive ear to their plea.

Unless financial conditions grow rapidly worse and seem likely to continue bad for some years, it is hardly likely that in the near future the commission will give its approval to a sweeping advance in either class or commodity rates.

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⁹⁷ Pp. 1990, 3152, 4959, 4961.

⁹⁸ P. 5491.